Asia-Pacific Banks Outlook 2022: The Long And Winding Road (To COVID Recovery)

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This report does not constitute a rating action

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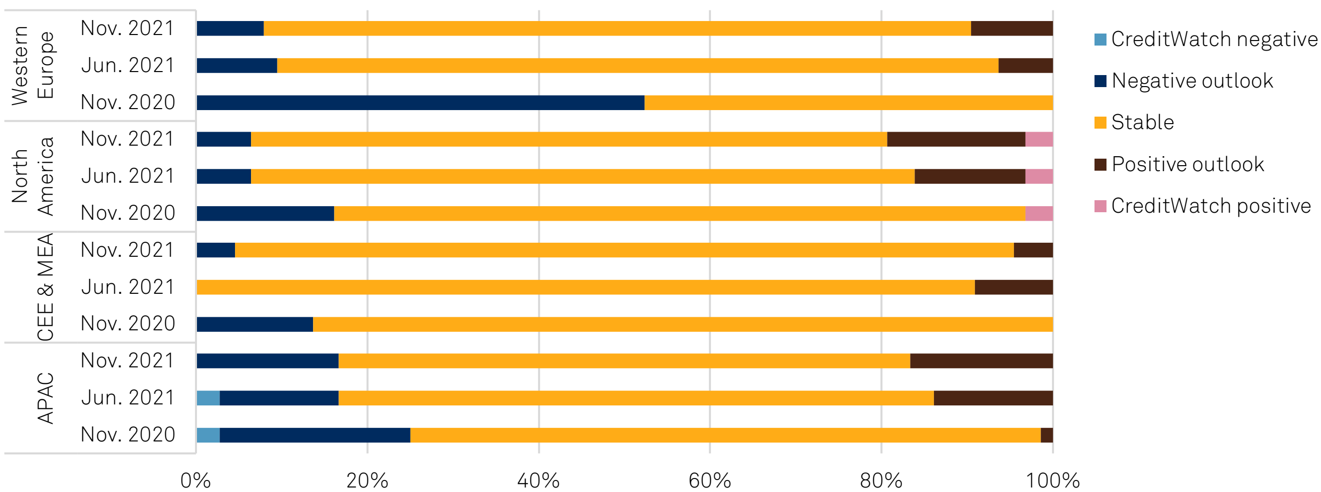
Key Takeaways

- About two-thirds of rating outlooks on Asia-Pacific banks are stable, reflecting improving economies and an ongoing rebound from the worst effects of the pandemic.
- Regional lenders still face a mixed bag of risks, principally developer defaults and deflating home prices in China, and weak economies in Southeast Asia.
- The possibility that economic recoveries may stall, in a context of ramped-up public and private sector leverage during the pandemic, adds to banks' risks.

Chart 1

Negative Outlooks Recede In Asia-Pacific and Globally Over 2021

Evolution of outlooks for the top 200 rated banks by region



Note: Outlook distribution is based on a selection of our top 200 banks excluding banks based in Latin America. APAC—Asia-Pacific. CEE--Central and Eastern Europe. MEA--Middle East and Africa. Source: S&P Global Ratings.

Ratings On Stable Path Heading Into 2022

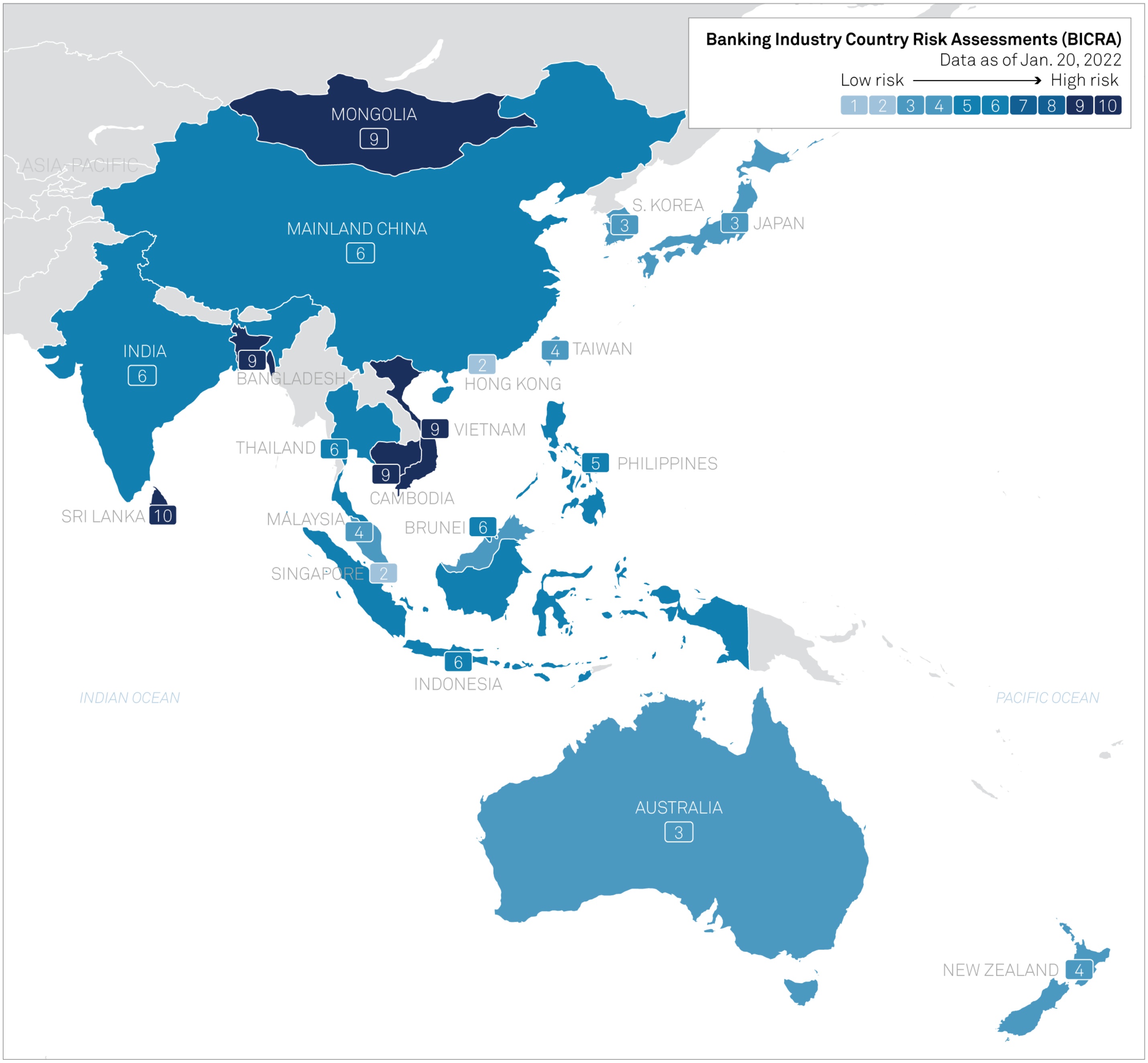
Our rating and outlook distribution reveals that Asia-Pacific banks are on a stable path heading into 2022. S&P Global Ratings believes this reflects improving economies and banks' recovery from a low base set in 2020 when COVID first hit.

Our net rating outlook bias for the Asia-Pacific banking sector improved to 0% in November 2021 from negative 24% in November 2020 (see chart 1). About 67% of rating outlooks on banks are stable. We believe that this stabilizing trend will continue, albeit with variability on this path. Asia-Pacific outlook trends broadly mirror those in other regions (see chart 1).

Risks continue to vary widely across the 19 jurisdictions where we rate banks in Asia-Pacific, from low risk to high risk (see chart 2 and table 1).

Chart 2

Risks Vary Widely Across Asia-Pacific BICRA Jurisdictions



Source: S&P Global Ratings.

Our Outlook Is Mixed For 2022

Prospects for banks across Asia-Pacific in 2022 are mixed. Economic trends affecting banks are negative in some Southeast Asian jurisdictions, including Malaysia, Indonesia, Thailand, and the Philippines (see chart 3). A high level of loans under moratorium in these jurisdictions are a latent risk factor amid high COVID-19 infections. In New Zealand economic trends are likewise negative, mainly driven by surging house prices. By contrast, we have a positive outlook on most Australian banks, reflecting improving systemwide funding. Trends are generally stable elsewhere across the region.

Property sector weakness in China will weigh on banks. Our current view is that the strains should be manageable for most rated banks at current rating levels. Our economic risk assessment on China is already at the higher-risk end of the spectrum (see table 1). As such, we anticipate that most rated banks can contend with some property sector weakness with no immediate hit on ratings.

Table 1

Key Economic and Industry Risks Diverge Full Spectrum Across Asia-Pacific

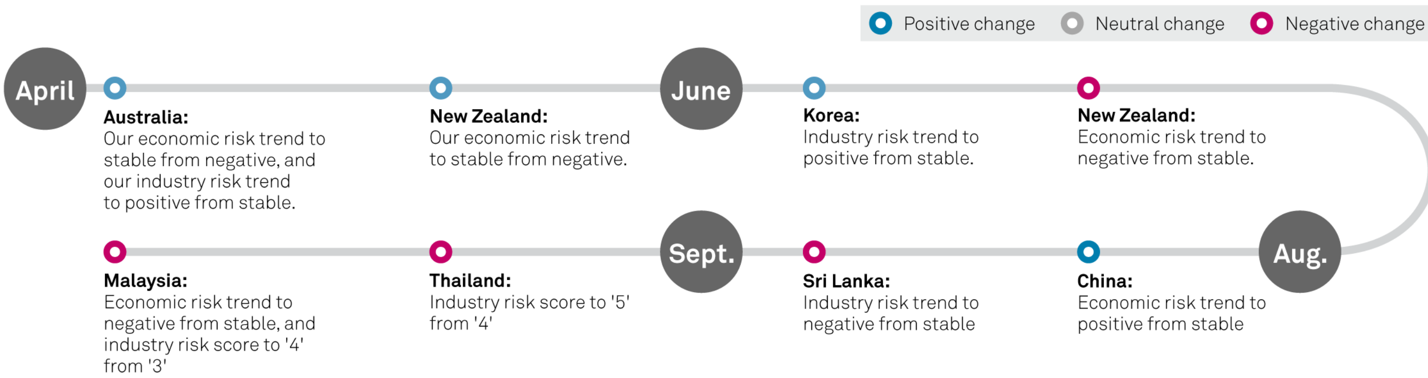
BICRA Groups globally range from '1' (lowest risk) to 10 (highest risk)

				--Economic risk --			--Industry risk --		
Region	**BICRA group**	**Economic risk trend**	**Industry risk trend**	**Economic resilience**	**Economic Imbalances**	**Credit risk in the economy**	**Institutional framework**	**Competitive dynamics**	**Systemwide funding**
Hong Kong	2	Stable	Stable	Low	Intermediate	Intermediate	Very low	Low	Very low
Singapore	2	Stable	Stable	Very low	Intermediate	Intermediate	Very low	Low	Low
Japan	3	Stable	Stable	Low	Very low	Low	Intermediate	High	Very low
Australia	3	Stable	Positive	Very low	High	Low	Low	Low	Intermediate
Korea	3	Stable	Positive	Low	Low	Intermediate	Intermediate	High	Low
Taiwan	4	Stable	Stable	Low	Low	Intermediate	Intermediate	Very high	Very low
New Zealand	4	Negative	Stable	Very low	High	Intermediate	Intermediate	Low	High
Malaysia	4	Negative	Stable	High	Low	High	Intermediate	High	Low
Philippines	5	Negative	Stable	Very high	Low	High	High	Intermediate	Intermediate
Brunei	6	Stable	Stable	Intermediate	Low	High	Extremely high	Intermediate	Low
Indonesia	6	Negative	Stable	High	Low	Very high	High	High	Intermediate
China	6	Positive	Stable	Intermediate	High	Very high	High	High	Very low
India	6	Stable	Stable	High	Intermediate	Very high	High	High	Low
Thailand	6	Negative	Stable	High	High	Very high	High	High	Low
Bangladesh	9	Stable	Stable	Very high	Low	Extremely high	Extremely high	Extremely high	Intermediate
Vietnam	9	Stable	Stable	Very high	High	Extremely high	Extremely high	Very high	Intermediate
Mongolia	9	Stable	Stable	High	Very high	Extremely high	Extremely high	High	Very high
Cambodia	9	Stable	Stable	Very high	High	Extremely high	Extremely high	High	Very high
Sri Lanka	10	Stable	Negative	Very high	Very high	Extremely high	Very high	Very high	Very high

Note: Data as of Jan. 20, 2021. BICRA -- Banking Industry Country Risk Assessment. Source: S&P Global Ratings.

Chart 3

Asia-Pacific BICRA Developments In 2021



BICRA--Banking Industry Country Risk Assessment. Data as of Jan. 20, 2022. Source: S&P Global Ratings.

Banks' credit losses remain high compared with those of 2019 (this is, the pre-COVID era) in numerous jurisdictions. Peak credit losses, however, will likely now be lower than we initially forecast. Nonperforming assets will remain elevated in some jurisdictions until banks can fully contend with the lingering hit on asset quality from the pandemic (see chart 4).

Chart 4

Nonperforming Assets Will Remain Elevated In Some Jurisdictions

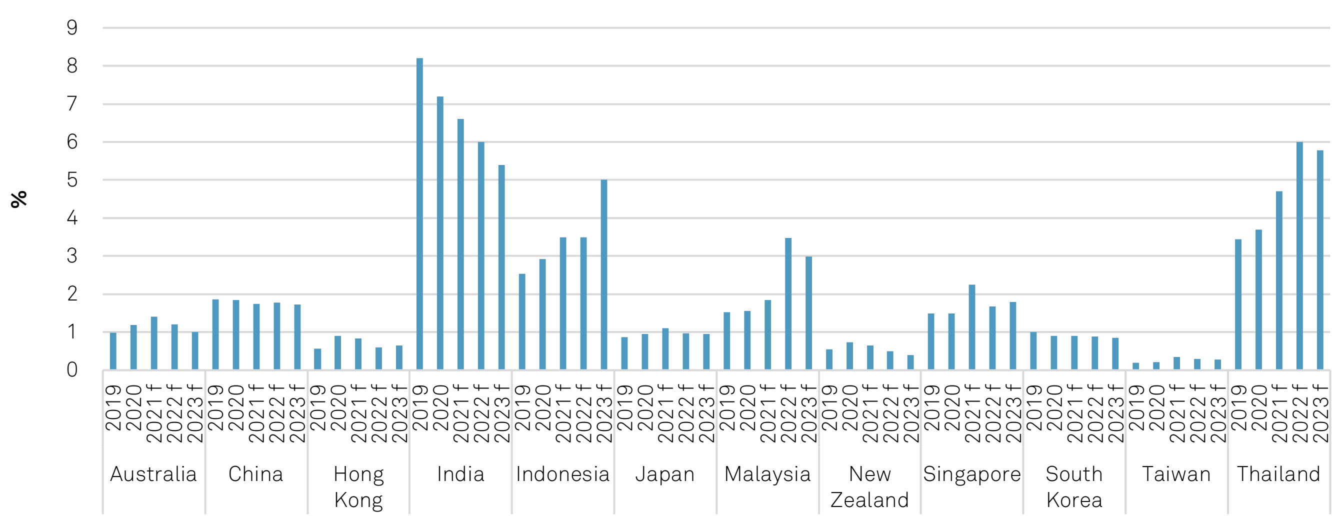


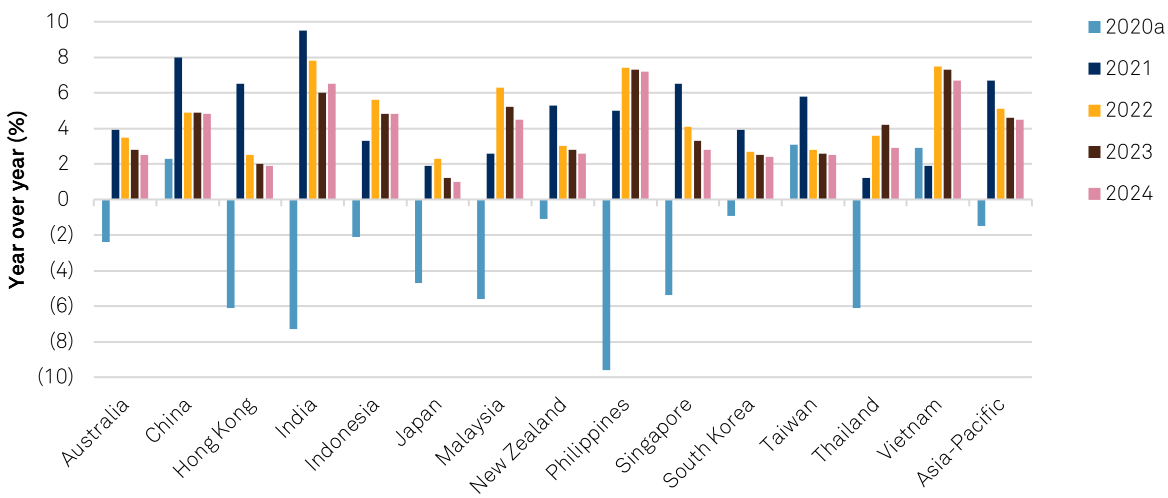
Chart reflects nonperforming assets as a % of systemwide loans (year-end). f – forecast. For India and Japan, 2020 refers to fiscal year ended Mar. 31, 2021. Source: S&P Global Ratings.

Economic Rebound And Government Support Are Key To Bank Ratings

Our assumption of a robust economic rebound underpins our base case for banks in 2022 (see chart 5). While the downturn in 2020 was significant, banks are clawing their way back as countries' economies recover. Furthermore, we anticipate that governments will continue to support banks. Fiscal and monetary policy backing for households and corporates from public authorities across Asia-Pacific has had a stabilizing effect on bank credit, even as officials taper away aspects of this help as the real economy recovers.

Chart 5

Likely Robust Economic Rebound Across Asia-Pacific To Support Banks In 2022



Note: For India, 2020 is fiscal year 2021 (year ending March 31, 2021), 2021 is fiscal year 2022 (year ending March 31, 2022), and so on.
a--Actual. Source: S&P Global Economics.

We reassert our longstanding view that extraordinary government support would likely come to many systemically important private sector banks across Asia-Pacific in the unlikely event it was required. This underscores a point of differentiation between Asia-Pacific and the rest of the world: governments are much more likely to support banks in this region (see chart 6). By contrast, in some other regions we believe that additional loss-absorbing capacity (ALAC) is a more likely support pathway for systemically important banks, rather than government support.

Chart 6

Most Asia-Pacific Banking Systems Benefit From Supportive Governments
Percentage of governments that are highly supportive, supportive, or where support is uncertain

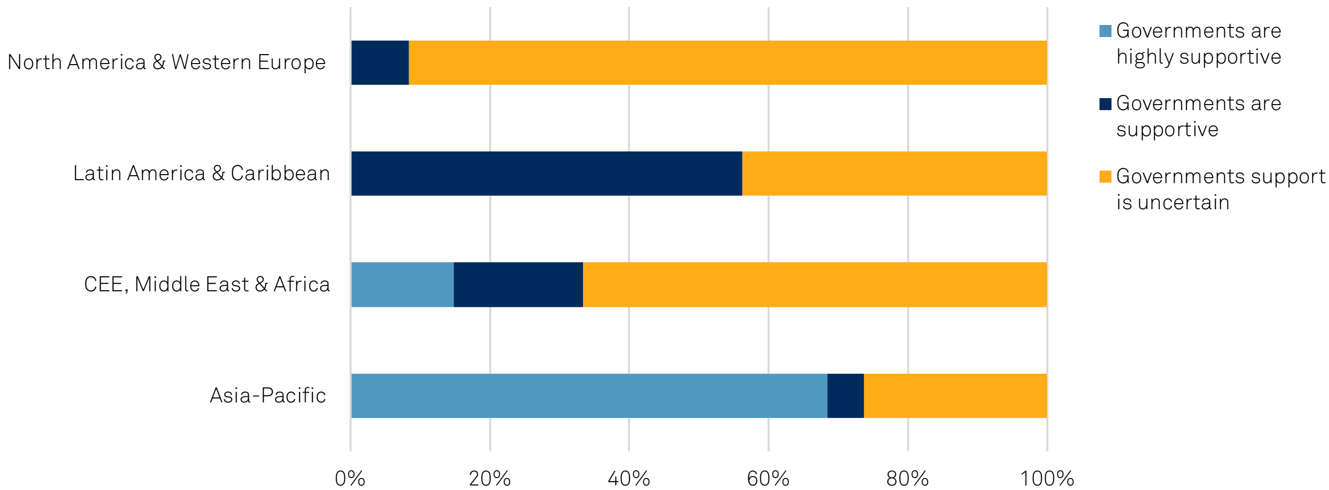


Chart shows extraordinary government support towards systemically important private sector commercial banks across banking jurisdictions within each region. In our assessment, governments are classified as 'highly supportive', 'supportive' or 'support is uncertain'. Data as of Dec. 2021. CEE--Central and Eastern Europe. Source: S&P Global Ratings.

Asia-Pacific Banks--Key Risks Linger

Our base case is that most banks are getting back on track, at least compared with the nadir of 2020 when the pandemic was most disruptive. But key risks remain. Principal among these is the possibility that economic recovery may stall either because of residual COVID effects or idiosyncratic factors across Asia-Pacific's diverse banking sector.

Scrambling to contend with the pandemic, corporates and governments increased debt leverage markedly in many jurisdictions. Higher private and public debt leverage has the potential to bite banks particularly as interest rates increase, and in different ways. Higher corporate insolvencies compared with pre-COVID levels will hit banks' asset quality. Higher government debt leverage may mean governments have less capacity, if not willingness, to support banks.

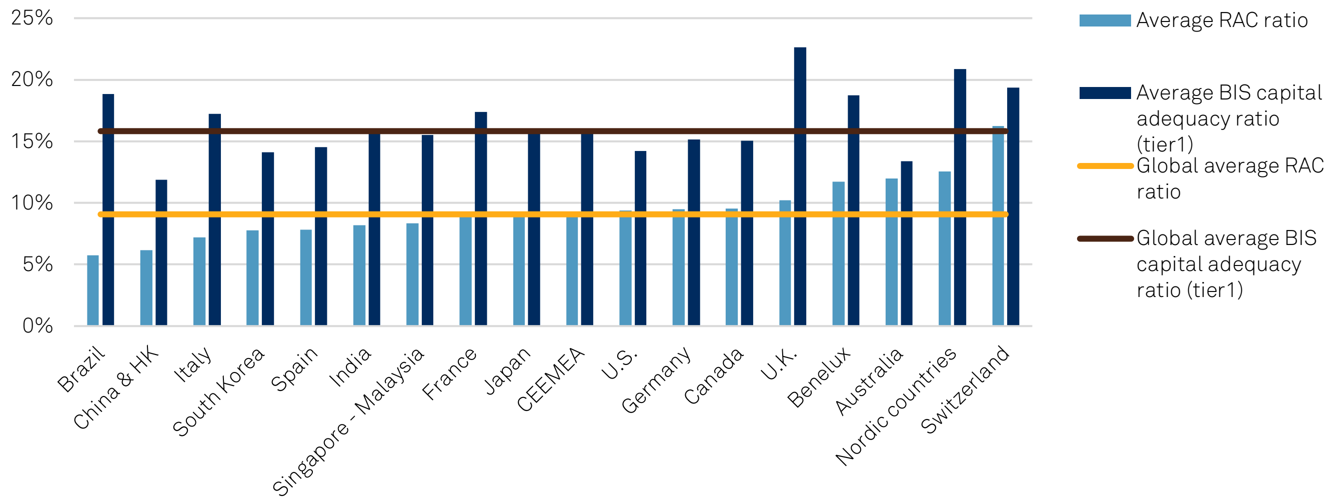
While we anticipate that banks' interest margins across the region will remain tight in 2022, we note that higher inflation will eventually alleviate some pressure on interest margins. A stable, orderly increase in rates will inevitably still weigh on credit losses across marginal borrowers although our base case is that this should be manageable at current rating levels. A key risk, however, is that reflation is disorderly, which could cause market disruption. The credit standing of banks is likely to take a turn for the worse under this scenario.

While we are focused on commercial property sector stresses in China, property sector risk factors have the potential to pick up elsewhere. Residential real estate represents a significant proportion of banks' loan books across Asia-Pacific. House prices in numerous jurisdictions have increased strongly, fueled by near-zero interest rates. This is contributing to economic imbalances that could eventually hurt banks. This scenario is already playing out in New Zealand, where we recently revised our economic risk trend to negative from stable mainly due to very strong house price growth. Other banking jurisdictions could yet be hit.

Chart 7

Banks' Capitalization Has Held Up During The Pandemic

The 2020 RAC ratio and BIS capital adequacy ratio (Tier 1) for the world's top 100 rated banks



RAC--Risk-adjusted capital. BIS--Bank for international settlements. Source: S&P Global Ratings.

Banks' capitalization across Asia-Pacific--and indeed globally--has held up well during the pandemic thereby buffering banks (see chart 7). We envisage that capitalization trends in 2022 will broadly remain stable and therefore be supportive of ratings for most banks at current rating levels.

Australia | BICRA Group: 3

Improving Funding And Economy Prop Up Australian Banks

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Key takeaways

- Improved funding profiles will help the Australian banking system as it digs out from COVID-19.
- We forecast financial institutions' credit losses will remain close to pre-pandemic levels in the next two years.
- Strong house prices, high household debt, and weaker lending standards could lead to tougher macro-prudential measures.

Key credit drivers

The Australian banking system's funding profile has improved over the past decade. This has occurred on the back of growing customer deposits and falling offshore borrowings. The stronger systemwide funding metrics could be sustained, in our view. That said, we expect a likely modest weakening in the next two years as the COVID-driven rise in customer deposits unwinds, the central bank's term-funding facility matures, and the committed liquidity facility is replaced.

Credit losses are trending lower. We believe bank credit losses peaked in 2020, following the damage inflicted by the pandemic. In our view, credit losses over the next two years should remain low and close to pre-COVID levels.

Key assumptions

Economy recovering strongly. We don't think the reduction in fiscal support from the government and the ending of bank loan deferrals will derail the recovery. We expect GDP to growth by more than 3% in fiscal 2022 and by 2.5%-3.0% in the next two years.

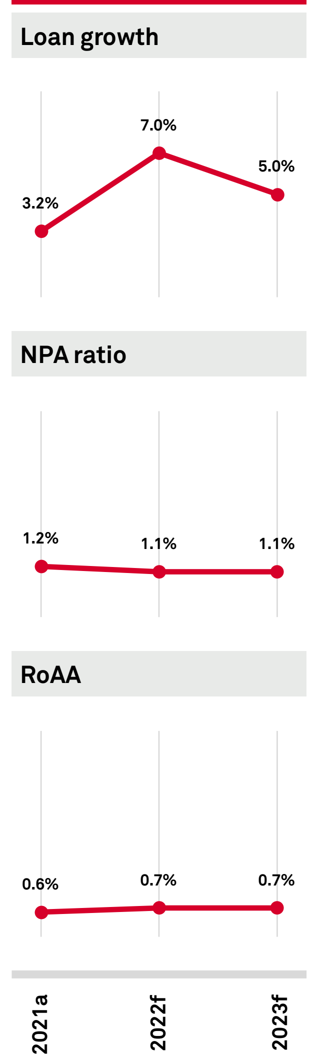
Banks' risk settings to remain conservative. We believe underwriting standards will remain unchanged and banks will continue to price rationally for risks, affording the sector buffers for unexpected situations--such as the current pandemic. Australian banks' earnings are set to stay strong relative to global peers notwithstanding pressures from low interest rates. However, over the longer term, continued weaker bank earnings could provoke greater risk-taking.

What to look for over the next year

Rising risks could lead to further macro-prudential measures. Appreciating house prices and accelerating home loan growth could heighten risks faced by the Australian banks; national house prices grew by about 20% during calendar 2021. In October 2021, the prudential regulator fired the first shot to mitigate these risks--it increased the minimum interest rate buffer by 50 basis points to 3% above the lending rate when assessing the serviceability of new home loan applications. We believe this measure won't achieve much. In 2022, the regulators are likely to reload and introduce further macro-prudential measures--such as restrictions on high debt-to-income lending.

Technology risks on the increase. Cyber risks present a growing threat to Australian banks. Accelerated digitalization and remote working arrangements since COVID-19 have increased such risks and could lead to more complex cyber attacks that trigger higher losses. A large-scale cyber attack can considerably hurt the Australian banks and pose systemic risks. Financial institutions need to be vigilant, and those with weak nonfinancial risk governance may be less prepared and more vulnerable to cyber attacks.

Australia



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Figures are for June year-end.

Bangladesh | BICRA Group: 9

COVID Legacy Still To Be Unwound

Key takeaways

- Although credit growth will pick up, profitability will remain weak.
- Regulatory forbearance masks underlying asset quality.
- Structural challenges persist for banking system.

Key credit drivers

Credit growth to pick up. We expect credit growth in Bangladesh to increase as the economy gradually normalizes over the next 12-18 months and as the domestic monetary policy remains expansionary. Recurring COVID-19 waves and lockdowns have disrupted economic activities in Bangladesh and reduced business and individual confidence. As a result, banks' credit growth had fallen to single digits for the better part of the last two years, from the long-term trend of about 15%.

Weak profitability to continue. We expect banks' returns on assets to remain muted. This is due to the twin effects of low net interest margins and some increase in credit costs. The regulator has capped interest rates at 9% for all loans barring credit-card loans since April 2020. This was followed by putting the floor rates for retail term deposits above the inflation rate last year. These measures have yet to be unwound. Furthermore, banks have to create provisions for COVID-related stresses which are currently masked by regulatory forbearance.

Bangladesh's banking system has lower profitability than regional peers'. That's because of moderate net interest margins owing to a fragmented banking system, moral suasion by the central bank, interest-rate limits, and low retail and small and midsize enterprise loan exposure (which typically offers higher yields). Fee income is low due to banks' limited product suites. Banks have high cost-income ratios because economies of scale are limited due to fragmentation.

Weak asset quality. Bangladesh's banking industry faces structural asset-quality challenges from weak lending standards and foreclosure laws. State-owned banks continue to hold large amounts of weak assets. Policymakers had provided a blanket loan moratorium to all borrowers till December 2020. The blanket moratorium was lifted in early 2021. However, given recurring COVID-19 waves, banks have been given the flexibility to provide COVID relief and not downgrade their loans to nonperforming loans. This flexibility is based on bank-client relationships and after borrowers satisfy certain conditions such as partial installment payments due by December 2021.

Key assumptions

External and domestic economic recovery is critical. We forecast real GDP growth will climb toward 7% in 2022 from a low base and amid a continued normalization of external and domestic demand, particularly in the second half of the fiscal year. The country's garment industry remains highly competitive globally, thanks to its low unit labor costs and ample supply of labor.

Structural challenges remain. Bangladesh's banking industry will likely face structural challenges from high credit risks, a fragmented banking system, weak governance at some banks, and the low capitalization of state-owned banks.

What to look for over the next year

Prudent capital management. State-owned banks will require sizable capital infusions to reach Basel III standards. Private-sector banks will need to limit their dividend payouts and growth ambitions and increase their provision coverage for COVID-related stresses.

BICRA report

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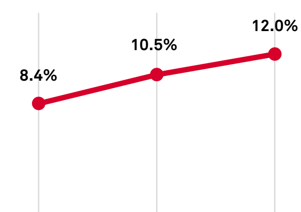
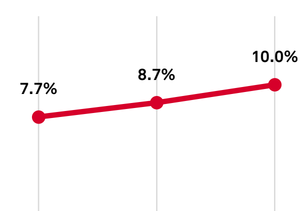
Bangladesh

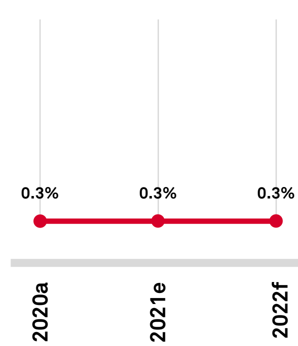
Loan growth



NPA ratio



RoAA



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Brunei | BICRA Group: 6

Stop-Start Economy To Dampen Loan Growth

Key takeaways

- Brunei's economy is facing headwinds despite multiyear high global energy prices.
- Profitability is likely to dip as interest margins stay low, while credit costs remain range-bound.
- Banks are likely to maintain strong balance sheets.

BICRA report

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Key credit drivers

Industry likely to see muted growth with lower profitability. We expect bank loan books to expand by low to mid single-digit percentages over the next few years. The bulk of the growth is likely to come from wholesale customers as the government looks to boost the economy and support local firms through contracts from government-linked companies, foreign direct investment projects, the oil and gas sector, and infrastructure development. Regulations on the total debt service ratio and a saturated market should continue to constrain retail activity.

Interest margins are set to remain weak given global interest rate settings to aid the global economic recovery. Rates should inch up later in 2022. We expect credit costs to be range-bound.

Range-bound deterioration in asset quality over the next 12 months. Domestic growth has weakened in recent quarters despite record global energy prices. This is due to the twin effects of lower output in the oil and gas sector, given the shutdown of some facilities, and a severe second COVID wave resulting in another set of lockdowns in the second half of 2021. The regulator has extended forbearance on certain loans till June 2022, to help people and businesses manage the effects of the pandemic. In April 2020, the regulator gave banks an option to defer payment of principal on loans for wholesale clients, and deferment or tenor extension (by conversion into term loans) for retail loans. Sectors that came under stress included aviation, tourism, and hospitality. Banks provided such COVID-related relief to a low single-digit share of loans as of the middle of 2021. We expect these forborne loans to rise as a share of the total.

Bank balance sheets are strong. The banking sector had a Tier-1 capital ratio of 19.9% and a loan-to-deposit ratio of 37% as of September 2021. Brunei banks have robust liquidity given the strong surpluses at the country's government and related enterprises, and limited lending opportunities.

Key assumptions

A high-income economy intertwined with developments in the energy market. Brunei's oil and gas industry accounts for close to half of the country's GDP and more than 70% of government revenues. The economic performance of the country remains tied to global energy prices and domestic oil and gas output as several production facilities are mature.

That said, the government's strong net fiscal asset position and oil wealth accumulated over several years are buffers against shocks. We expect the state to continue to draw down on its fiscal and external assets to support the economy, while diversification away from the oil and gas sector progresses gradually.

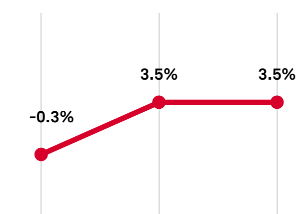
Government to remain supportive. In our view, there's a high likelihood that the Brunei government would provide timely and sufficient extraordinary support to major local banks, if needed.

What to look for over the next year

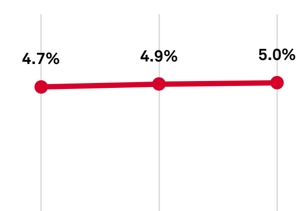
Financial sector reforms. Progress is being made toward establishing a bond market and a stock exchange to create alternative funding routes.

Brunei

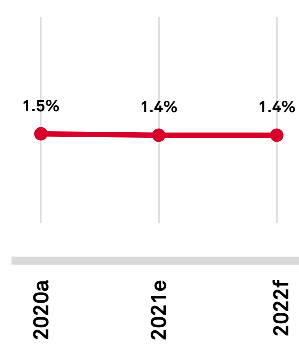
Loan growth



NPA ratio



RoAA



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Cambodia | BICRA Group: 9

Economic Rebound Under Way, But Underlying Risks Remain

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BICRA report

Key takeaways

- Economy has gradually reopened and growth is picking up pace.
- Nonperforming loans expected to increase as the loan restructuring program expired in 2021.
- Rapid credit expansion and dependence on real estate remains key risks.

Key credit drivers

Economic recovery under way. Cambodia depends heavily on external demand such as tourism, manufacturing, and construction, and suffered a 3.1% contraction in 2020 when these sectors were worst hit by COVID. The country re-opened in late 2021 after fully vaccinating more than 80% of its population. We believe the return of foreign investments will be gradual. That accounts for our forecast for real GDP to expand at a relatively modest pace of 2.6% in 2021, before picking up momentum to 6.3% in 2022. The export-oriented manufacturing sectors benefit from a recovery in global demand, which will support foreign direct investment.

Asset quality to be tested. The regulator allowed banks to conduct loan restructuring for COVID-hit clients until end-2021, including provisions for reduction or deferment of interest and principal. We estimate COVID-related restructured loans comprise 12%-15% of total loans, with the majority attributable to the worst hit sectors of tourism, transportation, garments, and construction. Reported nonperforming loans (NPLs) are expected to modestly increase to 2.5% in 2021 and spike up to 3.0%-4.0% in 2022 as the restructuring schemes lapse.

Key assumptions

Credit losses to increase. We forecast credit losses for Cambodian banks will increase to 100 basis points (bps) in 2021 and further to 150 bps in 2022, from 50 bps in 2020, reflecting additional provisioning costs for higher expected NPLs.

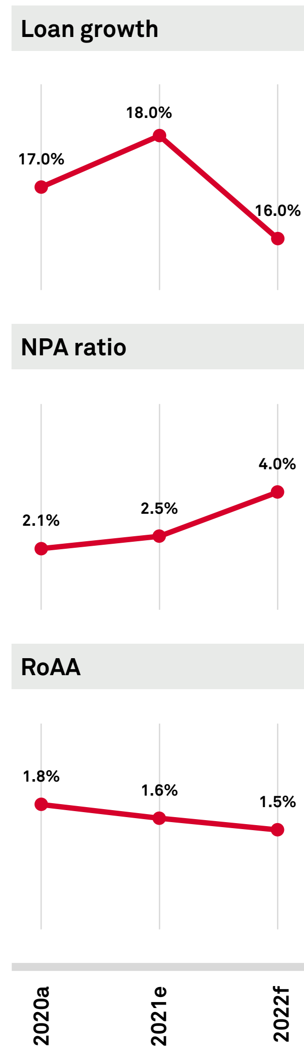
What to look for over the next year

High underlying credit risks due to multiple years of rapid credit expansion. Banks have aggressively grown their balance sheets from a low base and amid high GDP growth. The recession in 2020 resulted in a temporary slowdown in loans growth, but we believe credit expansion will remain brisk. The system's high share of high-risk exposures, particularly construction and real estate, leaves banks exposed to a sharp correction. We expect private sector credit growth in Cambodia to continue at a brisk 15%-20% annually for the next 12-18 months, with the ratio of private sector debt to GDP exceeding 160%.

Performance of real estate and construction sectors remains sluggish. Due to several years of rapid expansion, there remains an oversupply of residential real estate. The condominium segment grew strongly until 2019, but it has come under pressure since start of the pandemic, which disrupted international travel. Foreigners own the bulk of condominiums, and the resulting drop in arrivals and sales has led to weaker prices. Based on our estimates, inflation-adjusted property prices fell about 9% in 2020, and we expect prices to decline a further 12% this year before bottoming out. We believe further price correction will occur over 2022, and that stabilization will happen when the oversupply eases and travel activity returns to normal. Construction and real estate accounts for 18% of systemwide loans.

Boost for digital banking. We expect COVID-19 to continue driving digital adoption in banking-related services. The central bank has strongly pushed banks and customers to transact via cashless means, which should be a boon for banks with solid digital banking platforms.

Cambodia



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China | BICRA Group: 6

Limited Spillover Property Development, For Now Risk From

BICRA report

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Key takeaways

- New property-development stresses will likely make up 17% of our estimated nonperforming assets (NPA) for China banks at end-2021, adding 1 percentage point to our 5.8% NPA estimate before improving in ensuing years.
- Bigger and stronger banks set to perform significantly better while weaker banks struggle further.
- While Covid-related forbearance loans performed better than we expected, asset quality pressures are building up in micro and small enterprise (MSE) loans.

Key credit drivers

Adequate financial buffers at sector level. Overall, the country's banking sector is reasonably buffered to absorb worsening asset quality due to the economic slowdown and real estate sector shakeup. While property is weighing more heavily on bank asset quality, this impact has been partially offset by COVID-related forborne loans performing better than expectation. We think credit costs should begin stabilizing next year, in part because banks are likely to write off the pain this year and release provision coverage that was close to 200% of nonperforming loans (NPLs) as at third quarter 2021.

Credit divergence continues to worsen. We believe the largest China banks are well resourced and bigger and stronger banks set to perform significantly better while weaker banks struggle further. Some financial institutions could run into trouble over the next two to three years. We believe the government has sufficient resources and policy flexibility to support troubled commercial banks; however, such support could gradually become more selective. Furthermore, we believe authorities will take measured steps in reforms and balance financial stability when taking disciplinary actions.

Key assumptions

Stressed property development mostly not in NPL. We estimate one-third of Chinese property developers are in financial trouble. The bulk of this stress will likely show up as special-mention loans or other problem loans that don't require high levels of provision. Property development loans are typically well collateralized with residential real estate, for which we anticipate a moderate 3% nationwide decline in prices this year.

Elevated write-offs keep NPLs and NPAs in check. Our NPA ratio, our broader measure of asset quality that incorporates our estimate of 90-day overdue and restructured loans, is set to decline over the next two to three years to about 4.7% from 7.3% at end 2020. Our forecasts put annual credit losses at around Chinese renminbi (RMB) 2 trillion on average from 2021-2024. Write-offs are likely to remain elevated to keep the reported NPL ratio stable while constant pressure on credit cost should keep a lid on the sector return on average asset in 2022 and 2023.

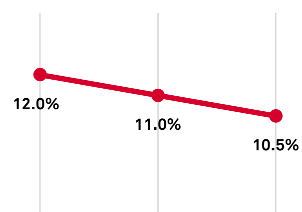
What to look for over the next year

Elevated credit growth but pressured profitability. We estimate overall loan growth at about 11% in 2022 and around 10.5% in 2023. A moderately relaxing monetary environment, fierce deposit competition, and concessional loan rates to policy-preferred sectors could further thin the sector's profitability. Property development market jitters still linger and are a developing story. A prolonged slump in housing confidence and spillovers to other sectors in the supply chain could add considerable pressure to loan quality.

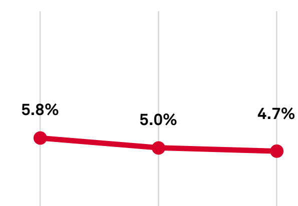
Asset quality pressures are building up for micro and small enterprise loan portfolios. This is due to slower credit stimulus, a sluggish recovery in consumption, and margin squeezes. It is also unclear if the borrowed money was invested in such a way that can sustain long-term margins to cover repayment. Hence the policy push to increase the proportion of unsecured loans to MSEs could see even higher write-offs.

China

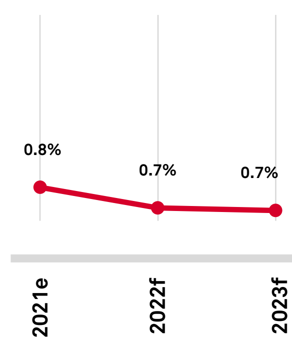
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Hong Kong SAR | BICRA Group: 2

Banks To Stay Resilient In 2022

Key takeaways

- Rising interest rates, higher level of fee income, and low levels of provisioning should support bank earnings. Omicron outbreaks and downside risk in the China economy stemming from recent policy stance and regulatory clampdowns have created some uncertainties mainly for the first half of the year.
- Prudent underwriting standards, sustainable capital, robust funding and liquidity, together with effective regulatory monitoring underline the strong fundamentals of the banking sector.
- U.S.-China tensions have eased, but an escalation may hamper the recovering business environment.

Key credit drivers

Risks to economic recovery emerge. The emergence of the omicron variant and the uncertainties in the China economy has added to the downside risks. Hong Kong and China's zero-COVID stance means occasional localized lockdowns are likely, along with tight border restrictions. The risk of economic disruption from reimposed restrictions remains fairly significant. Nonetheless, our base case remains that Hong Kong's GDP will expand 2.5% in 2022 and 2% in 2023, and China's GDP will grow 4.9% in 2022 and 2023. Ideological differences between China and the U.S. indicate the relationship will face ongoing challenges. Any intensification of disputes would be detrimental to trade and investment.

Strong fundamentals. Bank capitalization has remained solid owing to controlled lending, regulatory additional Tier-1 capital issuances, sufficient internal capital generation, and, in some cases, asset disposals. This provides Hong Kong banks with more buffers to absorb losses. Banks also benefit from stable customer deposits and limited reliance on short-term wholesale funding.

Key assumptions

Profitability recovery. We expect interest rates to increase from the current low level, which could boost net interest margins for the banks. On the other hand, banks are taking advantage of the growth in affluence in the region and increasing focus on wealth management and bancassurance to raise fee income. Over the next two years, we expect credit costs to remain low—slightly below the 30 basis point level we estimate for 2021. We do not expect any significant asset quality problems despite some contagion risk from the China property sector. We think the risk should be manageable as Hong Kong banks tend to only lend to the better-quality Chinese developers. The level of loans under the COVID relief measures is also reported to be at significantly lower levels than its peak, accounting for a small portion of outstanding loans.

Home prices to remain broadly stable. A structural housing shortage anchors Hong Kong's residential prices. However, second-order effects from the recent volatility in mainland China's property market and the risk of a protracted population outflow may dampen interest in homebuying.

What to look for over the next year

Rising share of income from the Greater Bay Area (GBA). Hong Kong banks are strengthening their presence in the GBA. Southern China will likely create economic opportunities and a demand for financial services. We expect banks to increasingly benefit from cross-border initiatives such as wealth management connect and China's opening up of its financial sector.

Digitalization ecosystem will continue to expand. The bank regulator's "Fintech 2025" strategy strongly pushes for banks to fully digitalize their operations. We expect sizable allocation within bank budgets for technology spending. Meanwhile, the digital banks should continue to be niche players and are likely to remain loss-making for the next two years due to their limited scale and product range.

BICRA report

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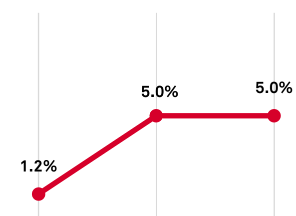
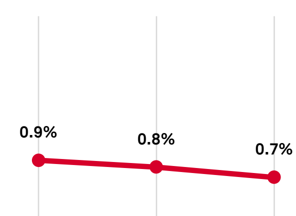
Hong Kong SAR

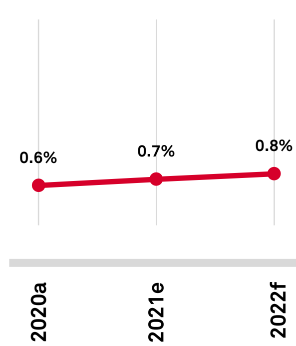
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

India | BICRA Group: 6

Indian Banking Sector At A Crossroad

Key takeaways

- Bad loans have likely peaked. Credit costs are set to fall to their lowest level in seven years.
- Improving profitability will further aid capital buffers, which have been improving due to banks' capital-raising activities and the government's capital infusions into public-sector banks.
- Stronger balance sheets and higher demand should boost bank loan growth. However, if risk management does not improve, then the coming growth cycle could produce a new crop of sour loans.

BICRA report

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Key credit drivers

Economic recovery to gain momentum. After India's peak in COVID-19 cases in mid-2021, the stringency index has declined, mobility has recovered, and consumer and business confidence has improved. The ongoing broadening recovery suggests that permanent costs are likely to be lower than previously feared. We expect real GDP growth of 9.5% in fiscal 2022 (ending March 31, 2022) and 7.8% in fiscal 2023.

Asset quality to improve gradually. We project the banking sector's weak loans will decline to 8% of gross loans by March 31, 2023, after peaking at almost 9% as on Sept. 30, 2021. Some intermittent impact on collection efficiency of financial institutions is possible from the third wave of COVID infections, but we expect the gradual improvement in asset quality to persist. Likewise, we forecast the credit costs for fiscal 2023 to continue normalizing to 1.6%, making credit costs comparable to that of other emerging markets. With an economic pick-up, residual stress for small and midsize enterprise and retail sectors should start abating. Nonperforming loan (NPL) recoveries are likely to also gain momentum, limiting the rise in NPLs.

Key assumptions

Economic resilience. India's economic growth prospects should remain strong over the medium term, with GDP expanding 6.0%-6.5% annually in fiscals 2024 and 2025. The economy's long-term higher growth rate versus peers highlights its historical resilience. India's wide range of structural trends, including healthy demographics and competitive unit labor costs, work in its favor. Additionally, we expect the government to remain supportive of the system. There is very high likelihood that the government will continue to support public-sector banks, notwithstanding plans to privatize two such banks.

What to look for over the next year

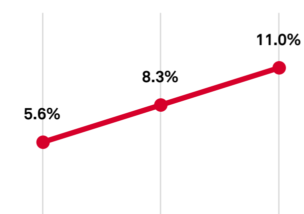
Economic pick-up will drive credit growth. In the next few years, we expect loan growth to stay somewhat in line with the trajectory of nominal GDP, and loan growth to the retail sector to continue to outperform the corporate sector. Corporate borrowing will be largely driven by working-capital needs in the next six months to a year, and capex-related growth will accrue to the banking sector with a lag. Still, if risk management does not improve, the coming growth cycle could produce a new crop of sour loans.

Improving profitability to further aid capital buffers. Lower credit costs and a pick-up in loan growth should sustain the turnaround in banks' earnings. We expect the return on average assets to normalize to 1% in fiscal 2023--an eight-year high. Improving profitability should augment capital formation. Capitalization has increased in the past few years due to banks' capital-raising, and the government's capital infusions into public-sector banks. Capital ratios are comparable to that of international peers for India's large private-sector banks, though they are lower for public-sector banks.

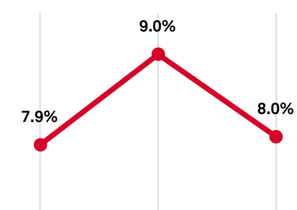
Polarization in the performance of banks. State Bank of India and the leading private-sector banks have largely addressed their asset quality challenges, and their profitability is improving more sharply than the system's. Many large public-sector banks are still saddled with weak assets, continued high credit costs, and poor earnings. Similarly, we expect a mixed-bag performance for finance companies (fincos). The asset quality of these fincos is often weaker than that of major private-sector banks.

India

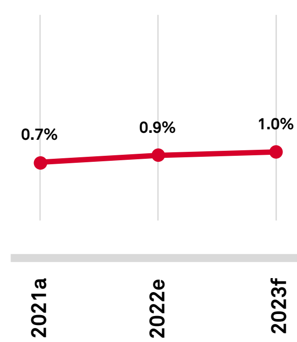
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming loans + restructured as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Figures are for fiscal year ending March.

Indonesia | BICRA Group: 6

Threat Of COVID Resurgence Clouds Recovery

Key takeaways

- Negative outlook reflects continued downside pressure on banks' asset quality due to COVID.
- Economic recovery is underway, but it could be derailed by COVID resurgence amid low vaccination rate.
- Indonesian banks remain among the region's most profitable, despite elevated credit costs.

Key credit drivers

Economic risk remains high. Economic risks faced by banks in Indonesia remain elevated in the aftermath of the second COVID wave in the country in July 2021. Restructured loans, which peaked at about 18% of total loans in 2020, declined to 14% in the third quarter of 2021. We forecast such loans to drop to 10%-12% in 2022 as economic activity picks up, and borrowers start repaying. Regulatory forbearance allowing restructured loans to be classified as performing until end-March 2023 has mitigated damage to bank financials. We forecast that nonperforming loans (NPLs) would stabilize at around 3.5% in 2022, thanks to the restructuring scheme, which would delay the recognition of stressed assets to 2023. In our opinion, one-tenth to one-eighth of the restructured loans are at risk and vulnerable to slippage into NPL, mainly those exposed to tourism or hospitability industries. This could add up to 1.5% of NPLs, which would crystallize in 2023 when the moratorium expires, suggesting NPLs could peak at 5% in 2023.

Strong capital buffers underpin ratings. Capital and provisioning buffers built up over the years should support Indonesian banks through the economic downturn. The banks' average Tier-1 capital ratio of 23.6% and capital adequacy ratio of 25.2%, as of September 2021, are among the highest in the region. Loan losses will remain elevated but are unlikely to reach the peak levels seen in 2021 given the pre-emptive provisioning has resulted in the average coverage increasing to over 180% as of September 2021, from 116% at end-2019.

Key assumptions

Elevated credit costs to recede. We expect credit losses for Indonesian banks to gradually decline to 200 basis points (bps) in 2022 and 180 bps in 2023 from about 250bps in 2021. Banks have significantly beefed up provision coverage and are likely to taper down on provisioning. Our forecasts incorporate Indonesia's GDP growth to rebound to 5.6% in 2022. Loan growth should recover to 8% in 2022 (from an estimated 5% in 2021), given an improvement in demand across sectors as the economy rebounds. Monetary policy will likely remain broadly accommodative with policy rates remaining at or near historical lows.

Profitability to improve. High credit costs hit the banking sector's 2020 profitability amid the implementation of IFRS 9 and additional provisions for potential asset quality deterioration due to COVID-19. The return on assets (ROA) for the banking sector improved to 1.9% as of Sept. 30, 2021, from 1.59% at end-2020, as credit costs receded. We expect ROA to marginally improve to 2% in 2022, but remain well below the pre-pandemic ROA of 2.47% in 2019. Nevertheless, the banking system would continue to rank among the most profitable in the region by a considerable margin.

What to look for over the next year

Economic recovery in 2022. Key downside risks for Indonesia's banking sector would be a significantly slower economic growth compared with our forecast. The country's third quarter 2021 GDP growth of 3.5% year on year, from 7.1% in the previous quarter, was weighed down by mobility restrictions from a rapid surge in COVID cases in July as the delta variant swept the country. Indonesia's vaccination rate of just over 40% as of Jan. 7, 2022, remains low, and any resurgence could translate to higher nonperforming assets and credit losses than we expected.

BICRA report

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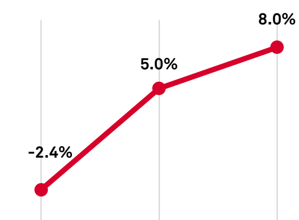
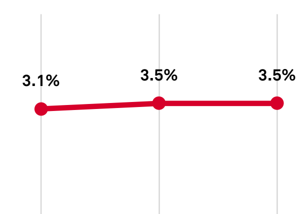
Indonesia

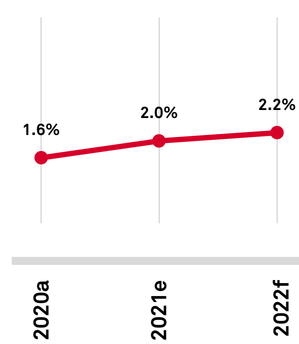
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Japan | BICRA Group: 3

Generous State Support May Come Back To Bite In 2022

Key takeaways

- Significant government support for companies will continue to curb an increase in bank credit costs.
- This government support has swollen the gross debt and deposits of corporations.
- Economic imbalances may present risks to banks if the increased debt is not addressed by rising deposits.

Key credit drivers

Government support. Significant government support for corporations and households has prevented a spike in bankruptcies in Japan and has limited the rise in banks' credit costs. The ratio of credit costs to total loans was 0.2% in fiscal year 2020 (ended March 2021), and we expect it to be at a similarly low level in fiscals 2021 and 2022.

Looming economic imbalance. Government support has increased the gross debt of the private sector by 7% (including bonds and commercial paper) and pushed up its deposit by 7%. The absolute rise in deposits was 1.6x that of debt. However, the higher gross debt may cause an economic imbalance if the private sector does not slash debt using the increased deposits once the COVID-19 situation stabilizes.

Key assumptions

Economy to recover in 2022. Although the situation remains fluid, we expect 2.3% growth in Japan's real GDP in 2022. This is after a 1.9% GDP growth in 2021 following the contraction of 4.7% in 2020 due to pandemic-related stress. Japan has the lowest percentage of COVID-19-related deaths per 100,000 population among G-7 countries, and we believe the government has been quick to activate safety nets and inject liquidity.

Profit contribution from loans to be muted. Increased demand for working capital from companies drove growth in loans in 2021. However, we expect the loan balance to start to decease in 2022 as corporates repay borrowings used to address emergencies. Although the net interest margins of major banks have been trending up, regional banks' weak interest margins will likely limit the upside in earnings from credit growth, which started in 2020.

Asset quality will be tested. We believe government support is temporary and the corporate sector's ability to repay debt is weakening amid falling revenues and profits. The real test of banks' asset quality will likely come after 2022 when most of the government support measurements will expire.

What to look for over the next year

Companies to start to repay debt taken for emergency use. Japan saw a temporary sharp rise in private sector debt relative to GDP in 2020 owing to various government support measurements. We expect the ratio to gradually return to pre-COVID-19 levels by 2023, subject to continuing economic recovery. Banks' nonperforming assets and credit costs will likely remain unchanged at 1.1% and 0.2% of total loans, respectively, in fiscals 2021 and 2022.

Overcapacity in the banking industry. We believe a fragmented industry structure makes Japan's banking system vulnerable. Overcapacity and dwindling interest margins due to competition have hit operating conditions for regional banks and will continue to constrain their returns. However, pressure on three major banks' profits is much muted as the entities have globally diversified revenue sources.

BICRA report

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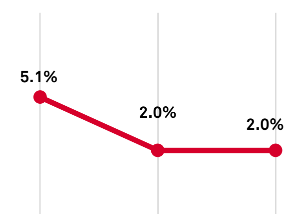
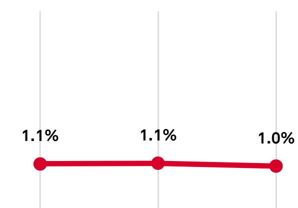
Japan

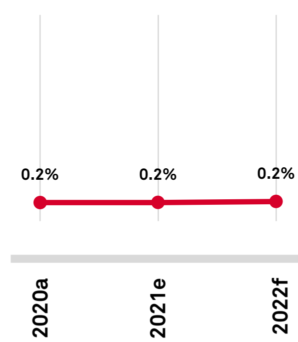
Loan growth



NPA ratio



RoAA



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Korea | BICRA Group: 3

Improving Profitability Amid Rising Domestic Interest Rates

Key takeaways

- Expansion of net interest margins amid rising domestic interest rates will improve the profitability of Korean banks, providing more buffer for absorbing credit losses.
- Adequate underwriting standards that consider borrowers' debt-servicing capacity will mitigate increased economic risks from high credit growth and rising housing prices in recent years.
- Effects of forbearance measures will likely be manageable.

Key credit drivers

Banks are managing asset quality well. Banks have strengthened their underwriting standards, in line with regulatory guidelines on the ratio of debt servicing to income. This will help them manage potential credit risks arising from high household debt. A low loan-to-value ratio for mortgage loans of about 45% on average by end-September 2021 and average household financial assets of about 2.2x household debt will also help. High collaterals for small and midsize enterprise (SME) loans and additional provisioning set aside amid the pandemic will provide some buffer against potential asset quality deterioration. We anticipate that the credit loss ratio will stay largely stable after some improvements in 2021. While the risk of economic imbalances has somewhat increased, the growth of private-sector credit and housing prices should moderate amid tightening underwriting and rising domestic interest rates.

Forbearance measures will likely be manageable. While the measures mainly include maturity extensions or interest-payment deferrals on loans to SMEs and small business owners, the portion of loans with interest-payment deferrals that we view as risky is limited. These were initiated only to non-delinquent borrowers. The loans accounted for about 5% of the banking system as of end-September 2021. SMEs and small business owners can request for such forbearance measures till end-March 2022.

Key assumptions

Credit growth will moderate. We expect loan growth to slow down to around 5% annually over the next two years as banks prioritize managing their credit risks. This is after the high growth in recent years amid COVID-19, fueled by an increase in loan demand from corporates partly backed by guarantees from government agencies. Mortgage loan growth was also high amid rising housing prices. Moderate loan growth and improving profitability will keep banks' capitalization adequate.

Steady economic growth. We forecast Korea's economy will grow by 2.7% in 2022, after rebounding 3.9% in 2021. The growth will likely be supported by solid exports. Operating conditions for banks will remain largely stable. We expect the Bank of Korea to raise the policy rate to 1.5% by end-2022 from 1.0% at end-2021, after raising the rate by 50 basis points in the second half of 2021.

What to look for over the next year

Improving profitability. We anticipate an expansion of net interest margins amid rising domestic interest rates to improve banks' profitability while credit costs stay largely stable. We believe returns on average assets will improve to around 0.55% in 2022, from our estimate of 0.5% in 2021 and 0.43% in 2020. This forecast is broadly comparable with that of Korea's peers such as the U.K. and Netherlands, although lower than that for Australia, Hong Kong, and Singapore.

Accelerating digital transformation. Internet-only banks are unlikely to disrupt the banking system much over the next few years. Incumbent banks have a balanced loan structure across corporates and households and will continue to strengthen their digital product and service offerings. Three internet-only banks have a small presence (about 1% of loans and deposits). They will likely focus on unsecured retail loans, especially expanding borrowers with mid to low credit profiles.

BICRA report

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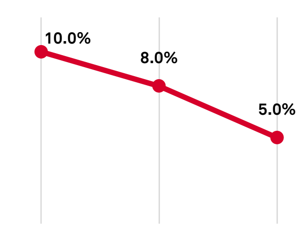
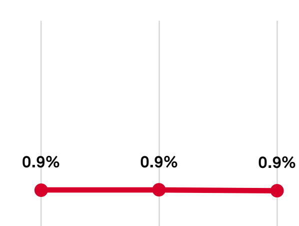
Korea

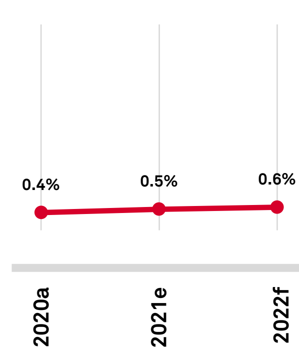
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

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a--Actual. e--Estimate. f--Forecast.

Malaysia | BICRA Group: 4

Credit Cost Stays Elevated Despite Expected Economic Recovery

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Key takeaways

- Industry NPL ratio will likely rise to 2.8-3.0% while credit costs will stay elevated at around 60 basis points (bps) by the end of 2022. This compares with our estimate of 59 bps for 2021 despite the distortions on reported asset quality due to the high moratorium take-up (28%-30% of sector loans) rates in the country.
- Negative intervention from the government (e.g. prosperity tax, two rounds of six-month automatic moratoriums, and a three-month interest waiver for the bottom 50% households) remains a risk given economic uncertainties and fiscal constraints.
- We assume the omicron variant will slightly delay, but not meaningfully hamper, the economic and business recovery of Malaysia in 2022.

Key credit drivers

Economic reopening curbs further downside risk for banks. In our base case, we are looking at a rebound of sector loan growth to 6.0% in 2022 from 4.5% in 2021. The recovery will be supported by ongoing economic reopening after a protracted lockdown and severe business disruptions for the most part of 2021. There could also be some upside for sector net interest margins (NIMs) as we forecast that Bank Negara Malaysia will start raising interest rates this year (a 25 bp increase in 2022 followed by another 50 bp increase in 2023). That said, the asset quality of Malaysian banks would weaken due to the removal of the distortions that multiple rounds of moratoriums and reliefs had brought about. We expect local banks to partially release their high allowance buffers on unimpaired assets to support the provisioning needs of the newly formed Stage 3 accounts. High write-offs will also increase the pressure on profitability. Adding in Budget 2022's one-off prosperity tax, all these could translate into muted bottom-line growth in 2022.

Solid capital and prudent dividend policies are still key strengths. We believe Malaysian banks' solid capital buffers (14.7% common equity Tier-1 ratios as of June 30, 2021) and prudent dividend payouts are key strengths that support the stability of the banks' credit standing and ratings.

Key assumptions

Omicron will not materially hamper economic and business normalization. Our current view on Malaysian banks is underpinned by our key assumption that the highly contagious omicron variant will only slightly delay, but not derail, the government's economic reopening efforts. A material detour of Malaysia's "living with COVID" push will lead us to reassess our view on the banking sector.

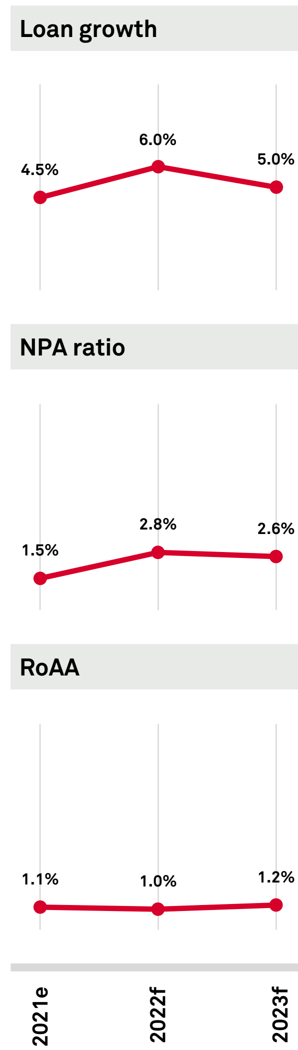
Improving employment conditions. Banks' asset quality hinges critically on employment in the country, given that 59% of the system's loan book is exposed to the household sector. We expect the unemployment rate to improve to 4.3% in 2022 and 3.8% in 2023, although still higher than the pre-pandemic level of 3.0%-3.5%.

What to look for over the next year

New COVID variants and economic reopening of Malaysia. New aggressive COVID variants, including omicron, remain a risk to GDP growth. A more protracted economic recovery could translate into rising job-market pressure and small-business woes. This would trigger more asset-quality pain for domestic banks.

Award of digital-only bank licenses. Market interest in Bank Negara Malaysia's digital-only bank licenses has been high despite the temporary disruptions and delays that COVID caused last year. The central bank will announce the winners of digital-bank licenses in the first quarter of 2022.

Malaysia



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Mongolia | BICRA Group: 9

Asset Quality Could Still Worsen Under Economic Recovery

Key takeaways

- We expect Mongolia's commodity-driven economy to extend its recovery, buoyed by mining activities and exports. A worsening of the pandemic and border restrictions are downside risks to our base case.
- We expect the industry's nonperforming asset ratio to increase as COVID-related concessional classifications end. Banks are also implementing stricter accounting standards and slowing down loan growth to meet higher capital demands.
- Tighter global financial conditions could pose refinancing risks, notwithstanding decreased foreign-currency funding of the banking system in recent years.

Key credit drivers

Economy is highly exposed to swings in commodity cycles. Mongolia's economy is heavily dependent on commodities, and the concentration of its trading partners amplifies the banking sector's susceptibility to acute shifts in commodity prices.

Regulatory standards are tightening. Regulators in Mongolia have in recent years gradually reduced the gaps in their regulations and disclosures versus international standards. Reforms include a review of the asset quality of the banking sector, contributing to tighter loan classification and provision requirements. Banks also have to meet higher capital requirements and implement International Financial Reporting Standards 9 (IFRS-9).

In addition, systemically important banks have to become open joint-stock ventures and comply with a single shareholder ownership limit of 20%. We believe such strengthened regulatory standards will increase banks' loss-absorbing capacity and improve governance and transparency. That said, the authorities have delayed the implementation of several initiatives to focus on the pandemic and deal with the associated stresses.

Key assumptions

Economic growth to continue in 2022, although downside risks remain. A pickup in global demand and rising commodity prices will support growth. A rebound in demand from China (which accounts for more than 90% of total exports) and improving commodity prices should be particularly helpful. Nevertheless, risks to Mongolia's economic growth remain, amid an evolving pandemic and border restrictions.

Strengthening capital regulations to hit credit growth. The regulators have strengthened Mongolian banks' capital requirements. Domestic systemically important banks need to comply with a 4% additional capital conservation buffer over the minimum regulatory Tier-1 capital ratio of 9% from July 1, 2022. As a result of these higher capital-ratio limits, we expect credit growth to vary among the banks. The higher limits could constrain the growth potential of banks with thin buffers.

What to look for over the next year

Asset-quality metrics to deteriorate. Asset-quality metrics could deteriorate as some banks adopt stricter IFRS-9 accounting standards for the year ended 2021. To deal with COVID-related stresses, the authorities have allowed banks to relax loan-classification standards. Loan moratoriums also defer asset-quality recognition. Mongolian banks have been temporarily allowed to classify retail loans up to 90 days overdue as performing loans. This measure has been extended to June 30, 2022, and is likely to weigh on banks' asset-quality metrics when it expires.

Profitability to be strained. Despite a recovering economic environment, banks' profitability is likely to weaken in 2022 and remain subdued in 2023. This is given lower margins and higher provisioning costs as forbearances end. Low interest rates will continue to compress margins.

BICRA report

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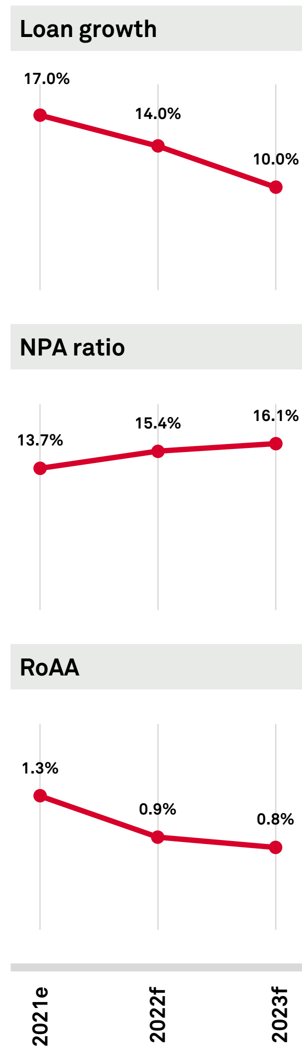
Mongolia



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a--Actual. e--Estimate. f--Forecast.

New Zealand | BICRA Group: 4

Runaway Housing Market Presents Rising Economic Risks

Key takeaways

- Economic risks facing financial institutions in New Zealand are increasing because of soaring house prices over the past 18 months.
- We see a one-in-three possibility that New Zealand banks could face greater risk of a disorderly correction in house prices over the next two years if the sharp price growth persists. This could result in higher credit losses beyond the two years.
- In our base-case scenario, credit losses should remain close to pre-pandemic levels over the next two years.

Key credit drivers

Heightened risk that house prices will continue to increase rapidly. Unprecedented house-price growth of 30% over the past 12-18 months has exposed financial institutions to rising economic risks. While the government and regulator have taken actions to mitigate the risks to financial-system stability from the resurgent house prices, these initiatives have so far been less effective in restraining house-price inflation than we previously anticipated.

Highly vulnerable to external shocks. New Zealand banks continue to face risks to their funding profiles. Their significant dependence on offshore short-term borrowing and the country's persistent current-account deficits and exposure to fluctuations in commodity prices all make New Zealand vulnerable to external shocks.

Key assumptions

Credit losses to remain close to pre-pandemic levels. A recovering economy, resilient employment levels, and sound sentiment will ease risks posed by unwinding fiscal stimulus and the end of repayment moratoriums. We forecast that annual credit losses will remain low and close to historical levels over the next two years, following a COVID-19-induced increase in 2020. New Zealand banks' profitability remains adequate to absorb credit losses.

New Zealand bank subsidiaries remain core to their Australian parents. We envisage no change in the strategic importance of the four major New Zealand bank subsidiaries to their Australian parents. This will support the credit quality of the banks, which account for over 90% of the New Zealand industry's assets.

What to look for over the next year

Policy support measures to cool house-price growth. In our base case, we anticipate successful regulatory and government actions to curb house-price growth. Measures to date include the reinstatement and subsequent tightening of loan-to-value restrictions, a tax-driven housing policy package, and the introduction of debt-serviceability restrictions over the coming months. If the measures are not effective in slowing house-price growth, downside risks to financial institutions will continue to rise.

Economy to continue strong recovery post-pandemic. New Zealand's economy is robust and outperforming many peers, in our view. This is despite a new COVID-19 outbreak in Auckland and slowing growth in the second half of 2021. We forecast real GDP growth of 3.0% for 2022, driven by consumption and investment, including residential construction.

Technology risks on the increase. Cyber risks present a growing threat to New Zealand banks, as demonstrated by DDoS attacks on the banking system in late 2021. A large-scale cyber attack can damage the risk profiles of New Zealand banks and pose systemic risks. However, the regulator's sectorwide cyber initiatives should strengthen cyber security, in our view.

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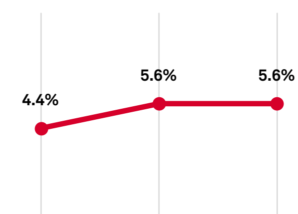
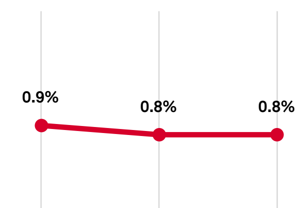
New Zealand

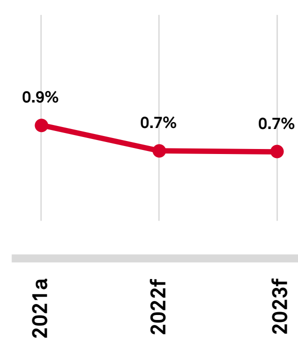
Loan growth



NPA ratio



RoAA



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Figures are for fiscal year ending in June

Philippines | BICRA Group: 5

Sustained Economic Recovery Could Lift Sector Profits

Key takeaways

- Philippine economy is on a recovery path and we forecast GDP growth of 7.4% for 2022.
- Higher credit growth and lower credit costs will improve banking-sector profitability.
- COVID resurgence amid new variants remain a key downside risk.

Key credit drivers

Economic recovery will gain momentum. The recovery is likely to gain pace with growth of 7.4% in 2022 as vaccination rates improve and COVID cases stay low. This compares with a 5% expansion in 2021, by our estimates, and a sharp contraction in 2020. Increased mobility and improved business and consumer sentiment will support a banking-sector recovery. Given that the vaccination rate in the Philippines is lagging peers', new and more infectious variants could potentially derail the budding recovery.

Banks maintain good buffers. The sector's good capital position (16.4% Tier-1 ratio) and provisioning provide a cushion against any unexpected losses.

Key assumptions

Credit losses will continue to moderate. We expect the sector's credit costs to decline to 0.9% of gross loans in 2022, from about 1% in 2021. By our estimates, the nonperforming loan (NPL) ratio will decline from its peak of 4.5%. This is because most stressed loans have either been recognized or restructured. Some slippage is possible from the restructured pool (3.1% of total loans), especially from the service sector. Banks' disposal of NPLs to asset-management companies could bring down the level of stressed loans visible in the system.

Credit growth and earnings will improve. Sector-wide profits are likely to strengthen in 2022, with the sector's return on average assets increasing to 1.2%. This is on the back of higher credit growth, growth in fee income as business activity picks up, and lower credit costs. We forecast credit growth of 5%-7% following better economic growth. Any reduction in banks' regulatory reserve requirement can push credit growth toward the higher end of our forecast.

What to look for over the next year

New COVID variants. New aggressive COVID variants, including omicron, remain a risk to the economic recovery. A reimposition of mobility curbs will hurt businesses and consumers, resulting in further asset-quality pain for the banking sector.

Ramp-up of digitalization initiatives. Banks will continue to tap opportunities presented by the pandemic by increasing investments in digital initiatives. Large universal and commercial banks should be able to fend off competition from the digital players. This is given their wide resources and longstanding customer relationships.

BICRA report

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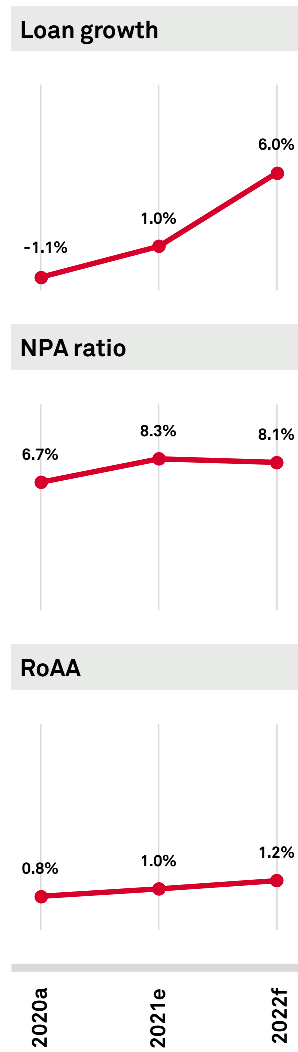

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Singapore | BICRA Group: 2

Banks To Stay Resilient In The Region's Endemic Transition

BICRA report

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Key takeaways

- Singapore banks should continue to recover on the back of strengthening regional economies and government efforts to facilitate a smooth COVID-19 endemic transition.
- Although recent cooling measures for the property market in Singapore will moderately dampen mortgage growth over the next 12 months, we expect the direct revenue impact to be limited. This is given local banks' strong revenue diversification.
- Asset quality of Singapore banks' ASEAN portfolios could worsen as nonperforming loans (NPLs) rise following the moratoriums' expiry over the next 12-24 months.

Key credit drivers

Business growth will likely benefit from a recovery of regional economies in 2022. Singapore banks led their ASEAN peers in recovering from COVID-19 in 2021. This was because the banks' main markets of Singapore (6.5% GDP growth in 2021) and Greater China (8.0%) staged solid rebounds from the initial economic shocks caused by COVID-19. We believe they can continue to benefit from business growth opportunities over the next 12 months as the recovery rotates to ASEAN markets.

We forecast strong GDP growth for Malaysia (6.3%), Thailand (3.6%), and Indonesia (5.6%) in 2022. These are all major ASEAN markets for Singapore banks, with aggregate exposure accounting for 10%-25% of their loan books. Our base case assumes loan growth of 6%-8% over the next 12 months with credit costs at the pre-COVID range of 25-35 basis points (bps).

Some upside for net interest margins (NIMs) and profitability and some downside for gross NPLs. We believe Singapore banks are poised for some margin upside in 2022 as very low interest rates begin to reverse. Balance sheets of the large Singapore banks are rate-sensitive and supported by an extensive buffer of low-cost customer deposits built during the pandemic. We believe an NIM expansion of 5-10 bps is possible in 2022, especially in the second half. Earnings could also be aided by the continuous release of general provisions, given our expectation of an economic recovery. Banks' gross NPL ratio could weaken to 2.0% over the next 12-18 months, given the lingering negative drag from their Southeast Asian portfolios.

Key assumptions

Omicron is not a game changer in Singapore's economic reopening efforts. Despite the very contagious nature of omicron, we assume the emergence of this new variant will not significantly alter the current "living with COVID" efforts of the Singapore government.

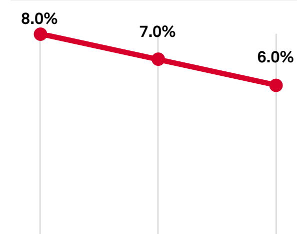
Government is highly supportive of businesses. We believe the Singapore government will support domestic businesses and minimize the negative impact of COVID on households. This in turn supports banks' financial prospects.

What to look for over the next year

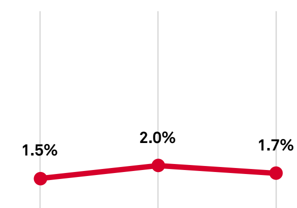
Digital-only banks start operations and the Monetary Authority of Singapore's (MAS) Project Orchid for a retail Central Bank Digital Currency (CBDC). Besides closely tracking the ESG developments and digitalization efforts of Singapore banks in 2022, we will focus on the operational mode and initial product offerings of the four digital-only banks in Singapore. Another interesting event to watch is Project Orchid announced by the MAS in November 2021. The MAS is studying with the private sector ways to build technology infrastructure and capabilities, which can support retail CBDC issuance, if needed, in the future.

Singapore

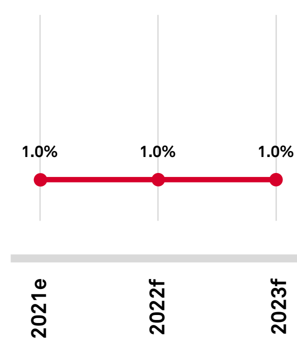
Loan growth



NPA ratio



RoAA



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Sri Lanka | BICRA Group: 10

Rising Sovereign Stress Continues To Weigh On Banks' Credit Profiles

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Key takeaways

- Sri Lanka's vulnerable external position could hurt the country's banks.
- Higher credit costs, lower profitability, and potentially weaker funding profiles will weigh on banks.
- Frequent regulatory forbearance on loan repayment could hurt the system's credit culture.

Key credit drivers

Heightened operating risk. We expect operating conditions for Sri Lankan financial institutions to stay weak over the next 12 months. The economy will recover modestly, with average real GDP growth of 4.2% from 2022-2024. But substantial downside risks to growth remain, particularly given the unpredictable nature of the pandemic and the emergence of new infectious variants.

Country's vulnerable external position. Sri Lankan financial institutions are unlikely to be immune to increasing credit pressures on the sovereign. The external profile of the sovereign remains weak--the high share of dollar-denominated debt exposes the government to shifts in risk sentiment. In our view, the government's access to external financing has become increasingly dependent on favorable business, economic, and financial conditions, increasing risk to its debt servicing capacity. This could hit the banking sector, although banks in the country have limited reliance on external funding relative to the sovereign.

Key assumptions

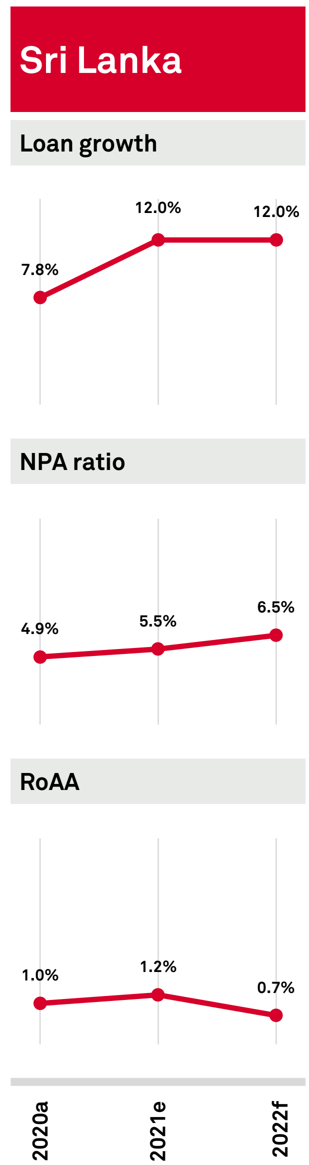
Government and central bank measures should provide some respite. These measures include multiple rate cuts, moratoriums, and restructuring. Since 2019, the Sri Lankan central bank has been allowing banks to provide a moratorium (until June 30, 2022, for the tourism sector and Dec. 31, 2021, for other affected) on loans. Alternatively, banks can also consider restructuring existing credit facilities over a longer period. In our view, regulatory forbearance may delay recognition of bad loans but is unlikely to address the problem. Also, protracted moratoriums could hurt the credit culture of the banking system.

Asset quality to weaken. We believe that the forbearance is leading to a widening gap in economic reality and reported numbers. Despite weak operating conditions, nonperforming loans (NPLs) haven't spiked, rising only 30 bps in first-half 2021 to 5%. NPLs will likely rise gradually to about 6.5% of total loans in 2022, from an estimated 5.5% in 2021. The restructured book will likely be another 5% of total loans. Weak nonbank finance companies, and tourism and related sectors will stay stressed. So will small and midsize enterprises, because they tend to have weak liquidity. The household sector could also bear the brunt of a slow economy, lower worker remittances, and higher unemployment.

What to look for over the next year

Funding profiles could weaken. Sri Lankan banks' external funding costs have gone up. We see a risk that the government may tighten restrictions on foreign currency outflows if Sri Lanka's external situation weakens further. These limitations may hurt investor confidence and translate into heightened external funding stress for the banking system. In our base case, domestic deposit holders' trust and confidence will remain intact. But banks' funding profiles could weaken if the stability of domestic deposits is affected. Downside risks to the banking industry will reduce only after the sovereign situation stabilizes.

Profitability to remain subdued. We expect Sri Lankan banks' margins to remain soft as interest rates stay low to support economic recovery. In addition, frequent administrative controls will continue to deter banks from pricing rationally. Elevated credit costs from a prolonged economic slowdown will also hurt profitability in 2022. We estimate credit costs to be 1.1% of total loans in 2021 and increase to 1.4% in 2022, compared with the five-year average of 0.7% through 2016-2020.



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Taiwan | BICRA Group: 4

Solid Capitalization Provides Buffer

Key takeaways

- Bank asset quality could weaken in 2022 as loan moratoriums likely come to an end.
- Solid capitalization to provide sufficient cushion to absorb higher credit losses.
- New virtual banks to speed up fintech development.

Key credit drivers

Continuous global demand and vaccine rollout. Steady world demand, particularly for electric devices, along with rising consumer spending as vaccine programs gradually roll out, should bolster Taiwan's export-reliant economy. We expect ongoing demand to underpin business growth and stable credit metrics for Taiwan's banking sector.

Interest raising cycle globally and domestically. Likely policy rate rises in the U.S. and Taiwan in 2022 will slightly boost banks' net interest margin.

Solid capital buffer. Banks have strengthened their capital over the past few years in line with regulatory requirements, with the average common equity Tier-1 capital ratio at 12.9% as of end-September 2021. This should provide a sufficient buffer for banks to absorb rising credit costs.

Key assumptions

Exports to drive economic growth. We project Taiwan's economy will expand by 2.8% in 2022, down from 5.8% growth in 2021, due to the higher base effect. Despite a rebound in COVID-19 infections since May 2021, we believe Taiwan's economy will emerge relatively unscathed from the pandemic. Global demand for electronic products and components, corporate reshoring as Taiwan companies return part of their operations to Taiwan, and sustained investments in the local semiconductor sector will drive GDP expansion. We expect loan growth to return to the normal trend rate of 4.8% in 2022. This follows high loan growth in 2021, partly due to government stimulus.

Government's proactive measures should help. Government relief measures--fiscal stimulus, monetary easing, soft loans, credit guarantees, tax reduction, and compensation to COVID-19-hit businesses--continue to support borrowers' debt servicing capacity, in our view.

What to look for over the next year

Asset quality metrics to slightly weaken by the end of 2022. We expect banks' nonperforming assets (NPAs) ratio to slightly weaken in 2022. The government's loan moratorium program--which began in 2020, with new applications likely finishing at the end of 2021--may push NPA recognition into 2022. In our opinion, the overall asset quality of Taiwan's banks will remain manageable given the NPAs are increasing from a low base and banks have sufficient provision buffers.

The bottom line will likely remain flat in 2022. We project banks' profitability will remain flat in 2022. A slightly improved net interest margin will likely be offset by higher credit costs. Volatile capital markets will also strain profitability.

Shift in customer behavior amid COVID outbreak accelerates adoption of digital banking. COVID-19 has increased digital banking transactions in Taiwan. Two virtual banks launched operations in 2021. This, along with the increasing customer comfort with, and use of, digital banking during the COVID outbreak should accelerate fintech adoption. Most banks in Taiwan have raised their information technology capital expenditure and continue to enhance virtual connections with customers. Nonetheless, these developments are unlikely to change the banking sector landscape over the next two years.

BICRA report

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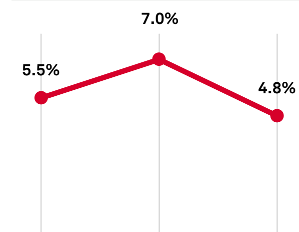
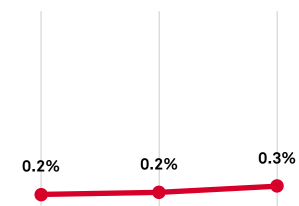
Taiwan

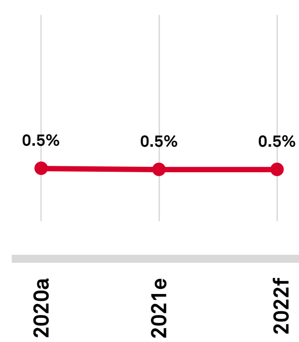
Loan growth



NPA ratio



RoAA



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Thailand | BICRA Group: 6

Weak SMEs And Leveraged Households Pose High Risk

Key takeaways

- Banks in Thailand remain more vulnerable to COVID-19 than Asian peers, given the country's reliance on tourism, and high household and corporate leverage.
- Credit losses will remain at an elevated 1.5% of gross loans in 2022.
- Economic recovery is key to stabilizing credit conditions.

Key credit drivers

Thailand's high household leverage and banks' SME exposure pose risks. The pandemic has hit Thailand hard due to the country's reliance on tourism and exports. In our view, the current challenging environment will hurt the debt-servicing ability of small and midsized enterprises (SMEs) and low-income households. Credit risk is already heightened in Thailand, given very high household debt and corporate debt as well as pre-existing structural weaknesses in the SME segment. Thailand's household leverage, at 90%, is one of the highest among emerging markets and has reached unsustainable levels. In our view, banks will need to restructure loans, especially retail loans, due to the fragile state of household debt, and bear the losses on some of these loans.

Liberal regulations are delaying recognition. Thailand's regulatory forbearance for loan classification and for relief measures is lenient compared to peers' and will likely raise systemic risk for its banks. We believe that these measures will prolong the recognition of underlying problem loans. Balance sheets will become opaque, with the delayed recognitions of nonperforming loans (NPLs).

Key assumptions

Increasing divergence in economic reality and reported numbers. NPLs haven't spiked because of the ongoing relief measures. But at 14%, the high proportion of banks' loan books under relief measures points to incipient problems in the system. In our base case, which projects an orderly unwinding of imbalances, we expect banks' NPLs to rise gradually in the next 12-24 months. We also anticipate that the NPL ratio will peak at 5% by the end of the cycle, the highest since the 2008 global financial crisis.

Government relief measures will soften the blow to banks, but downside risks are rising. We believe that steps taken by the government and central bank should reduce the hit to banks. But, they won't eliminate all the risks. We see rising downside risk of asset quality being worse than our base-case expectations, especially after the unwinding of forbearance measures. We expect credit costs for the Thai banking system to remain elevated at about 1.5% for the next couple of years at least.

What to look for over the next year

Economic revival is key to credit recovery. The pandemic has pushed back the likely timelines for greater normalization of domestic activity and a gradual resumption of tourism. The drag on tourism will continue to weigh on the Thai economy in 2022. Economic revival is vital to stabilize credit conditions. A prolonged delay in Thailand's economic recovery would deepen the downside scenario for domestic banks, given high household leverage and the weakness in the SME sector. Of the six Thai banks we rate, four have negative outlooks.

Good capital and provisioning levels offer some cushion. Thai banks generally have good credit buffers, with high capital adequacy ratios and provision coverage compared with peers'. As of Sept. 30, 2021, the system's provision coverage was about 155%, with a capital adequacy ratio of 19%. Banks' improving earnings also aided these buffers. We believe the Thai banks that we rate can absorb the blow from deteriorating asset quality. But the downside risk remains high.

BICRA report

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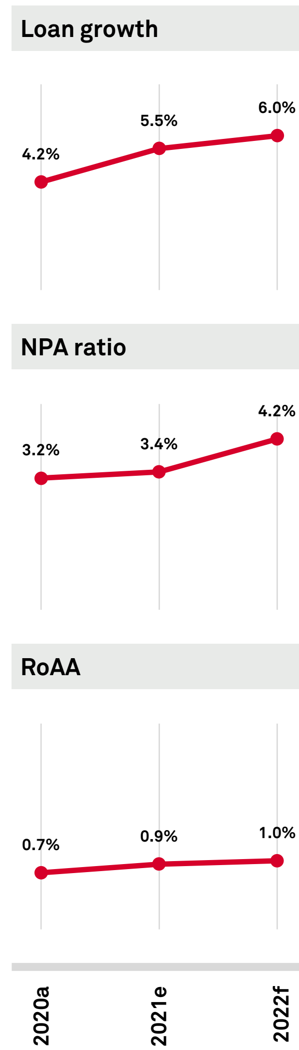
Thailand



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Vietnam | BICRA Group: 9

Asset Quality Risk Remains While Covid Restrictions Are Being Lifted

BICRA report

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Key takeaways

- Banks are likely to see brisk credit growth amid expansionary monetary policy and reopening of the economy.
- We expect stable profitability, partly due to regulatory forbearance.
- COVID has delayed structural reforms on capital, asset-quality recognition, and provisioning.

Key credit drivers

Fast growth. Credit growth in Vietnam is likely to be 13%-14% over the next 12-18 months. Key drivers include low interest rates, abundant liquidity, and reopening of the economy. While majority state-owned banks are capital constrained, several mid-tier private-sector banks are likely to expand loans by 15%-30%.

Stable returns on assets. Net interest margins for banks are likely to remain stable as they continue to enjoy a low cost of funding. Noninterest income is likely to expand briskly on the resumption of export-led trade finance and foreign exchange income, cross-sales of retail products (e.g., insurance), e-transaction channels, loan processing, and card fees. We expect a range-bound increase in credit costs for Vietnam banks due to regulatory forbearance.

COVID-19 related credit cost pushed back. The reported asset quality of the banks in Vietnam deteriorated modestly in 2021. This is due to the combined effects of liquidity support to borrowers at lower interest rates and continuation of loan restructuring by the central bank. Such restructured loans formed about 6% of total outstanding loans at the end of 2021 on an accumulated basis. The regulatory forbearance to restructure the loans without lowering the classification of such loans will continue until June 2022 and banks are provided a three-year window for provisioning.

Key assumptions

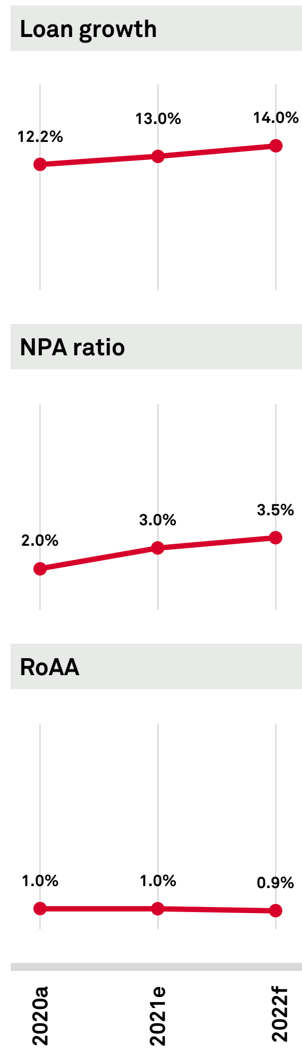
Manufacturing sector and strong domestic demand to invigorate growth. Vietnam's economy has been battered in 2020 and 2021 by the slowdown stemming from the pandemic. In 2021, the delta variant proved overwhelming, resulting in strict lockdowns. It interrupted production and disrupted supply chains, leading to GDP expansion of only 2.6%. We forecast GDP expansion of 6%-7.5% in the next three years as growth settles closer to Vietnam's long-term trend. The country's export-led manufacturing sector (especially electronics) and strong structural domestic demand will keep the trend growth rate well above the average of its peers.

What to look for over the next year

Capital management. Capital buffers at several Vietnamese banks remain thin, and some state-owned banks need urgent help to improve capitalization. In this respect, buoyant global capital markets remain an avenue. However, foreign ownership in banks is still restricted to 30%.

Structural reforms agenda. The banking sector faces several structural challenges such as high and increasing leverage in the economy, thin capitalization, and weak asset quality recognition. The pandemic has pushed back improvement on several of these aspects. For example, the deadline for all the banks to attain Basel II standards has been extended to 2023. The central bank also extended loan forbearance till June 2022. It remains unknown if these items will get back on track.

Vietnam



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